



## ADMINISTRATIVE SERVICES DEPARTMENT

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### AUDIT COMMITTEE STAFF REPORT

Meeting: January 26, 2026

#### Subject

Consider the Other Post-Employment Benefits (OPEB) and Pension Trust Investment Policies

#### Recommended Action

Review and accept the OPEB and Pension Trust Investment Policies

#### Discussion

##### *Background*

In Fiscal Year (FY) 2009-10, the City established a Section 115 Trust to help fund its retiree health obligations, also known as OPEB. In FY 2017-18, the City also established a Section 115 Trust to pre-fund its pension obligations and reduce the potential impact of pension cost volatility on the City's operating budget.

#### **OPEB and Pension Trusts**

##### *Section 115 Trust Overview*

A Section 115 Trust is a tax-exempt investment tool that allows local governments to pre-fund pension and retiree health costs. The benefits of a Section 115 Trust include the following:

- Local control over assets: The City controls the contributions, withdrawals, investment strategy, and risk level of assets in the Trust.
- Potential for higher investment returns than General Fund: Investment requirements that apply to the City's General Fund assets under Government Code 53601 are not applicable to Trust assets.
- Pension rate stabilization: Assets can be transferred to CalPERS at the City's discretion to pay for Normal Cost or Unfunded Accrued Liability (UAL) contributions and can be used to reduce or eliminate large fluctuations in the City's pension costs.
- Diversification: Trust assets will be diversified from CalPERS investments.

### *OPEB Trust Overview*

In FY 2009-10, the City established a Section 115 Trust to help fund its retiree health obligations, also known as OPEB. Compared to a pay-as-you-go plan, the OPEB Trust allows the City to:

- Grow assets to pay future OPEB benefits.
- Earn higher returns than the General Fund.
- Reduce its total cost for providing post-employment benefits.
- Reduce its Net OPEB Liability.

In July 2010, the City contributed \$7.0 million in initial funding. With additional contributions of \$12.3 million, total contributions to date are \$19.3 million.

As of June 30, 2025, the City's OPEB Trust had a market value of \$42.7 million and had earned an annualized investment return of 7.68% gross of fees since inception.

Time Period	Annualized Investment Return
1 Year	12.80%
5 Year	8.93%
Since Inception	7.68%

1-Year investment returns were impacted by financial market volatility due to heightened geopolitical risk, supply chain bottlenecks and persistent inflation, and the Federal Reserve's pivot to a less accommodative monetary policy.

As of the June 30, 2025, measurement date, using a 6.5% discount rate, the City's OPEB plan had an accrued liability of \$41.5 million and a market value of assets of \$42.7 million, resulting in a net asset of \$1.3 million and a funded ratio of 103.0%. Compared to June 30, 2024, the unfunded accrued liability became a net asset, primarily due to favorable market conditions.

	June 30, 2023*	June 30, 2024*	June 30, 2025*
Accrued Liability	35,290,000	40,389,000	41,472,000
Market Value of Assets	34,708,000	38,013,000	42,734,000
Unfunded Accrued Liability	582,000	2,376,000	(1,262,000)
Funded Ratio	98.4%	94.1%	103.0%

\*Amounts provided from Actuarial Report, as opposed to PARS provided.

### *Pension Trust Overview*

Since pension obligations are one of the City's largest financial obligations, the City has taken proactive steps to reduce the impacts of pension cost volatility. In March 2018, the City provided options to Council to address rising pension costs. In April 2018, the City presented a long-term pension funding strategy to the Fiscal Strategic Plan Committee. In May 2018, the City adopted a Section 115 Trust, also known as a Pension Rate Stabilization

Program (PRSP), to reduce pension rate volatility on the City's budget. The Pension Trust helps the City to:

- Grow assets for future pension contributions.
- Invest assets over appropriate time horizons.
- Earn higher investment returns than the General Fund.
- Reduce pension contribution volatility.
- Diversify funds from CalPERS investments.

As a fiscal sustainability measure, the City funds the Pension Trust using a more conservative discount rate of 6.25%. The City's pension funding goal is to accumulate sufficient funds in the Pension Trust to fund the difference between a 6.25% and a 7% discount rate and achieve a funded status of 80% by FY 2036-37, 20 years from the adoption of the Pension Trust. The City's projections indicated that it would need to accumulate over \$42 million in the Pension Trust within 20 years to achieve its pension funding goal.

As a result, the funding strategy proposed \$8.0 million in initial funding, along with additional funding of \$10.0 million over the first five years. To date, the City has contributed \$16.0 million, including:

- \$8.0 million in FY 2018-19
- \$4.0 million in FY 2019-20
- \$2.0 million in FY 2020-21
- \$2.0 million in FY 2021-22

As of June 30, 2025, the City's Pension Trust had a market value of \$24.3 million, a year-over-year increase of \$2.7 million, and had earned an annualized investment return of 8.03% gross of fees since inception.

Time Period	Annualized Investment Return
1 Year	12.64%
5 Year	8.86%
Since Inception	8.03%

Driven by favorable market performance, the Trust achieved a 12.64% return over the past year. Five-year and since-inception returns remain strong at 8.86% and 8.03%, respectively, underscoring the City's long-term strategy to promote pension funding stability.

#### *OPEB and Pension Trust Investment Policies*

The Audit Committee is responsible for reviewing the OPEB and Pension Trust investment policies annually, appointing investment managers, and monitoring

investment performance. The City Council is responsible for annually adopting the OPEB and Pension Trust investment policies.

It is not expected that the OPEB and Pension Trust investment policies will change frequently. Short-term changes in the financial markets should not require adjustments to the policies.

The Audit Committee last reviewed the policies on October 31, 2024, with City Council adopting the policies on December 3, 2024.

Public Agency Retirement Services (PARS) is the City's Trust Administrator and PFM Asset Management is the City's Investment Manager for the Pension and OPEB Trusts. The Investment Manager manages the investments per the investment policies. Within the constraints imposed by these policies, Investment Managers are expected to comply with all applicable fiduciary and due diligence requirements under the "prudent investor" rules.

#### *OPEB and Pension Trust Investment Objectives*

The OPEB Trust has a "Balanced" investment objective with a target rate of return of 6.50%, and the Pension Trust has a "Balanced" investment objective with a target rate of return of 6.25%. The "Balanced" investment objective is designed to provide a moderate amount of current income with moderate growth of capital. Investors should have sufficient tolerance for price and return volatility and substantial periodic declines in investment value. This objective is recommended for investors with a long-term time horizon.

As part of ongoing efforts to align with evolving industry best practices and enhance portfolio diversification, Global Infrastructure has been formally incorporated into the strategic asset allocation. Similar to Real Estate and Commodities, Global Infrastructure is recognized for its inflation-hedging characteristics, stable cash flows, and historically low correlation to traditional equities and fixed income assets.

The strategic asset allocation ranges and tactical targets for this objective are listed below:

Asset Class	Range	Target
Fixed Income	20-40%	29%
Equities	50-70%	63%
Real Estate	0-10%	3.5%
Global Infrastructure	0-10%	3.5%
Commodities	0-10%	0%
Cash	0-10%	1%

The target rates of return are based on the long-term expected rate of return for assets in the trusts and the City's time horizon for the investments.

With strong reserves and a fully funded OPEB plan, the City can maintain a long-term investment horizon with a "balanced" investment objective. There may be periods of substantial decline in investment value, and the portfolio should expect periodic volatility. However, a 6.56% return on investment is expected over the long-term, based on the current investment objective. More conservative investment objectives such as "moderate" and "moderate-conservative" would expect less volatility and declines in investment value; however, over the long term, they would also expect lower returns. Many agencies anticipate needing to access the funds in their respective trusts sooner and invest with more emphasis on preserving capital in the near term.

The OPEB Trust has a higher discount rate than the Pension Trust because OPEB investments are expected to have a longer time horizon. OPEB obligations are generally longer in duration, and the City expects to withdraw Pension Trust funds earlier to fund CalPERS contributions. Given that changes to the CalPERS discount rate have larger effects on the City's operating budget and are farther out of the City's control, it is important that the City be able to use the Trust to pay CalPERS contributions as needed.

**Sustainability Impact**

There is no sustainability impact.

**Fiscal Impact**

There is no direct fiscal impact at this time.

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Prepared by: Jonathan Orozco, Acting Director of Administrative Services and City

Approved for Submission by: Tina Kapoor, City Manager

**Attachments:**

A – OPEB Trust Investment Policy

B – Pension Trust Investment Policy